

PERFORMANCE DECLINE AND TURNOVER IN INDONESIAN MANUFACTURING FIRMS

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Abstrak

Penelitian ini bertujuan untuk menyelidiki penyebab-penyebab penurunan kinerja dan strategi-strategi pemulihan kembali perusahaan-perusahaan manufaktur di Indonesia, yang erat kaitannya dengan krisis keuangan yang terjadi pada tahun 1997/1998. Sampel untuk penelitian ini adalah perusahaan-perusahaan manufaktur berskala besar yang ada di Indonesia. Dari hasil penelitian menunjukkan bahwa perubahan persaingan perusahaan, manajemen perusahaan yang kurang bagus, perubahan ekonomi dan kegagalan proyek-proyek utama perusahaan merupakan faktor-faktor yang menyebabkan penurunan kinerja perusahaan selama krisis 1997/1998. Sementara strategi restrukturisasi adalah strategi utama yang digunakan oleh perusahaan manufaktur untuk melakukan pemulihan kembali perusahaannya.

Keywords : Turnaround, Performance Decline

Introduction

By the mid-1990s, after three decades of economic growth in Indonesia, the manufacturing sector's contribution to the GDP creation has surpassed that of agriculture. One important characteristic of the Indonesian manufacturing industry was its high dependency on imported raw materials and intermediate goods (Widianto & Choesni, 1999). There was no question about this dependency when raw materials and intermediate goods could not be obtained domestically.

Unfortunately, the 1997/1998 financial crisis which started in Thailand and spread to other countries, such as Malaysia, South Korea and other parts of Southeast Asia including had a bigger tell on Indonesia. The consequence of crisis of 1997/1998 was domestic prices of tradable goods adjusted upwards because of higher world prices (in Rupiah terms), because of the dramatic depreciation of the exchange rate.

High interest rates coupled with difficulties in the banking system led to a reduction in private sector borrowing during this period. Real wages fell in 1998 and investment slowed to a trickle. Construction, manufacturing, and banking and finance sectors were hardest hit in terms of the fall in real value added. Within the manufacturing sector, construction materials, steel production, transportation, and wood products recorded the greatest decline in real value added; between minus 23 and minus 55 percent. Indicative of the sharp decline in aggregate demand,

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imports had fallen by 36 % in the 10 months to October 1998 compared to the same period in 1997. Total US\$ value exports showed a decline in the 8 months to August 1998 (Widianto & Choesni, 1999). During that period, most of the companies were affected by the financial crisis such that some went into distress or some even to the point of bankruptcy. However, many companies still survived after the crisis following drastic turnaround strategies.

This study is meant to determine the causes of decline of Indonesian firms. It will also enlighten what strategies were used to turnaround the firms to overcome the decline and crisis.

Literature Review

External and internal of environments of business have been proposed as the factor to trigger turnaround strategies into action. Business situations can translated into many variables, such as causes of decline. In this research, causes of decline will be investigated. The decline itself refers to the decline of firm performance for a period of two years.

The cause of decline is an important determinant to the turnaround strategies (O'Neill, 1984). Similarly, Hofer (1980) stated that the selection of turnaround strategy is contingent upon the situation, and the situation can be internal and external factors that are historical and anticipated (Rasheed, in press).

The earliest study about cause of business decline by Argenti (1976), found that the causes of corporate decline are poor management, lack of accounting information, firm unresponsive to change, failure of big projects, environmental change, hostile environment, normal business hazards, lack of financial control, over trading, high gearing, and competition. Bibeault (1982) found that the reasons for corporate decline are sheer bad luck, external environment beyond management's control, real balance of external and internal factors, internal problems triggered by external factors and internally generated problems within management's control. Slatter (1984) found poor management, high cost structure and lack of financial control, as the factors that contributed to the decline of firms in U.K.

Heng, Ibrahim and Jantan (1995) looked at ten potential causes of corporate decline in small, medium and large-size organizations in Malaysia. They found the following causes: lack of financial control, poor management, competition, high cost structure, changes in market demand, adverse movements in commodity price, lack of marketing efforts, failure of major projects, poor acquisition, and weak financial policy. Only two factors, they i.e. lack of financial control and failure of major projects, seem to influence decline in medium size organizations. However, the study shows that none of the causal factors were influential in large sized organizations.

Slatter (1984) identified ten major generic strategies for turnaround, which UK firms commonly applied as; change of management, strong central financial control, organizational change and decentralization, product market reorientation,

improved marketing, growth via acquisitions, assets reduction, cost reduction, investment, debt restructuring and other financial strategies.

O'Neill (1986) investigated the relationship of contextual factors to the effectiveness of four primary turnaround strategies; management (new head executive, new definition of business, new top management team, morale building among employees), cutback (cost cutting, financial and expense controls, replacing losing subsidiaries), growth (new product promotion methods, entering new product areas, acquisition, add markets), and restructuring (change in organizational structure, new manufacturing methods). His model correctly predicted a negative relationship between growth strategies and turnaround success where there were strong competitive pressure. Where firms were in weak market positions, success was found for cutback and restructuring strategies.

In addition, it can conclude that the factor causes of companies decline can divided into external factors such as economic changes and competitive changes. Moreover, the internal factors, such as poor management, lack of financial control, high cost structure and failure of major projects. The most important strategies during turnaround attempts are management strategies, cutback strategies, growth strategies and restructuring strategies. Thus, it will discuss specifically on the relationship between those external and internal factors with turnaround strategies.

Economic decline is rather subjective, and there are very few data available on industry or company incidence of economic decline (Bibeault, 1982). The company could be in an economic decline for years and yet, in the absence of legally enforceable debt, be able to meet its current obligations and thus not be a legal failure. Firms' choice of several strategies in crisis is contingent on a range of factors (Sudarsanam & Lai, 2001). Generally, it is accepted that the higher the level of economic changes the greater is the chance of turnaround or conversely the lower the level of economic changes, the lesser is the chance of turnaround strategy undertaken.

Competitive change can cause decline (Bibeault, 1982). A firm that fails to be competitive is likely to find itself sliding towards extinction. Slatter (1984) noted that price competition as the main cause of decline in British manufacturing industry, due to price competition from overseas competitors in motorcars, motorcycle, machine tools and textiles. Francis and Mariola (2005) suggest that external environment is the starting point for testing the factors that influence turnaround strategies. Specifically, external attribution of decline is positively associated with the extent of top management team replacement in turnaround (Barker & Barr, 2002). It seems that the higher the level of competition the greater the chances of turnaround or conversely the lower the level of competition the lesser the chance of turnaround.

Poor management is one of the main factors in the organization contributing to the organizations' decline (Hambrick, 1992). This is supported by several previous studies (Argenti, 1976; Bibeault, 1982; Maimon, 1999; Slatter, 1984). They found that the prime cause of industrial sickness was poor management. Slatter (1984) stated that the companies in poor management situation require new management, organization change and decentralization. Barker and Barr (2002)

found that top management problems give the impact on the organization decline, which more likely leads to turnaround strategies than external causes of performance decline. The more ineffective is the management team the greater seems the chances of turnaround.

Lack of financial control is one of the causes of performance decline in the companies (Argenti, 1982). The appropriate turnaround strategies implemented when lack of financial control occur in the organization are new management, improved financial control and decentralization (Slatter, 1984). It is deemed that lack of financial control influences the turnaround strategies adopted. The higher the lack of financial control is the greater the chance of turnaround. Thus, when the financial control is adequate there will be less chances of turnaround.

One of the most frequently cited causes of performance decline is the failure of major projects (Maimon, 1999; McRobert, 1997; Slatter, 1984). This is because major projects require heavy investment and the failure of such investment to take off profitably can strain the cash flows and costs are underestimated or revenues over estimated. Slatter (1984) stated that the failure of major projects in an organization influenced turnaround strategies implementation such as asset reduction. Thus, we can argue that the higher the failure of major projects the greater is the chance of turnaround strategies undertaken.

Unfortunately, few studies had conducted to identify the factors that contribute to the crisis that brought Indonesia to become the most seriously hit country by in Asia since the economic crisis in 1997/1998. One of the studies was by Simanjuntak (1999) who found that the large business in Indonesia is organized as conglomerates. For instance, the Salim Group, the largest business group in pre crisis Indonesia, had no less than 602 companies associated with its owners and managers in 1996. The Center for Business Statistics of Indonesia (1997) reported such diversification into unrelated business was typical in all large business groups and there was a very high level of concentration in almost all industries. Chinese Indonesians assume a dominant position in the highly concentrated ownership structure that were associated with oftentimes unfair business practices, including the formation and maintenance of mutually beneficial relationships with political rulers. Hence, there is also little study on the turnaround strategies in Indonesian firms. Turnaround strategies that adopted successfully by companies in the West might not be similarly effective in Asia region. Bruton, Ahlstrom, & Wan (2003) found that the turnaround strategies that succeeded in the West or US could not automatically adopted in the East especially in ethnic Chinese businesses.

From the literature review above, the following model is proposing:

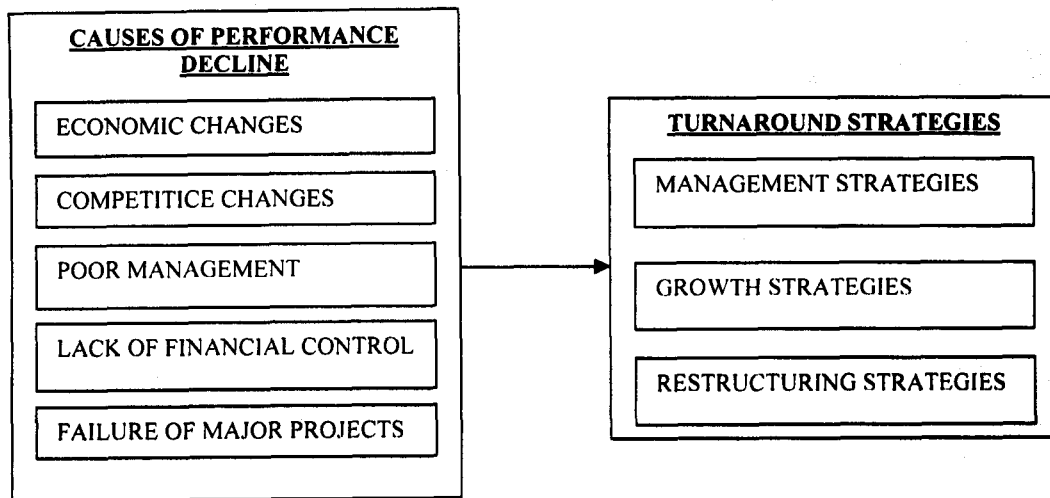


Figure 1
Corporate Turnaround Model

Figure 1 show the framework used in this research. From the literature reviews and the model the following hypothesis are proposed:

- Hypothesis 1: Economic changes will lead to management strategies.
- Hypothesis 2: Economic changes will lead to growth strategies.
- Hypothesis 3: Economic changes will lead to restructuring strategies.
- Hypothesis 4: Competitive changes will lead to management strategies.
- Hypothesis 5: Competitive changes will lead to growth strategies.
- Hypothesis 6: Competitive changes will lead to restructuring strategies.
- Hypothesis 7: Poor management will lead to management strategies.
- Hypothesis 8: Poor management will lead to growth strategies.
- Hypothesis 9: Poor management will lead to restructuring strategies.
- Hypothesis 10: Lack of financial control will lead to management strategies.
- Hypothesis 11: Lack of financial control will lead to growth strategies.
- Hypothesis 12: Lack of financial control will lead to restructuring strategies.
- Hypothesis 13: Failure of major projects will lead to management strategies.
- Hypothesis 14: Failure of major projects will lead to growth strategies.
- Hypothesis 15: Failure of major projects will lead to restructuring strategies.

Methodology

The causes of decline and turnaround strategies were examined by surveying the CEOs of Indonesian manufacturing firms. The firms chosen were those with more than 250 employees, categorized as large companies, (Urata, 2001). One thousand questionnaires sent to 1000 large companies that randomly selected from the Bureau of Statistics Indonesia, 2002. The firms chosen based on the criteria; the firms that categorized in performance decline during the Asian

financial crisis of 1997/1998. They asked whether they were in the hardship of performance during that period. The firms that increase in the performance will be exclude from the study.

Measures and Procedures

The questionnaire consists of four parts. They are causes of decline, turnaround strategies, profile of respondent and profile of companies. The survey on causes of decline consists of 22 items. Example: (1) devaluation of major currency; (2) inflation; (3) interest rate; (4) the mergers of two or more competitor; (5) product competition; (6) price competition; (7) the announcement of a competitor's new range of products; (8) non participating board; (9) one man rule; (10) unbalanced top team; (11) lack of management depth; (12) a chief executive who believes he/she can achieve fantastic success in any business or sector; (13) untimely implementation; (14) underestimating capital requirements; (15) budgetary control; (16) cash flow forecasts. The questionnaire for turnaround strategies consists of ten items. The example of the items are: (1) new head man (from inside the company); (2) new top management team; (3) growth via acquisition; (4) entering new product area; (5) improved marketing; and (6) change in organization's structure.

The survey items selected based on the previous studies about causes of decline by Argenti (1976), Bibeault (1982), Slatter (1984) and turnaround strategies of Slatter (1984), O'Neill (1986). Respondents were asked to rate the causes of decline according to five Likert scale of: (1) not serious at all, (2) not serious, (3) moderately serious, (4) serious, and (5) most serious. For turnaround strategies scale used was: (1) not used at all, (2) used to a little extent, (3) moderately used, (4) used to a large extent, and (5) used as the central strategy. The survey questionnaire was translated into Indonesian language by the Language Center (English), and then it was translated back into English to assure accuracy of translation.

From 1000 questionnaires sent, only 171 responded, with seven refusing to participate, and 63 were unusable, thus only 101 questionnaires were used for further analysis. The companies were located mainly in Java, though a few were in Sumatra and the outer islands.

Results

Sample Profiles

The profile of respondent presented in table 1 below. Majorities of the respondents were male (87.1 %), while female only (12.9%). Their ages according to age groups are 20-29 (5%), 30-39 years old (36.6%), 40-49 (26.7%), and more than 50 years 31.7%. Twenty-nine point seven of respondents have been working for 6-10 years, 23.8% 11 and above years, and 1-5 years is 22.8%.

Table 1
Summary of Respondents' Profile

Respondent's profile	Categories	Number of respondents	Percentage (%)
Age	20-29 years old	5	5.0
	30-39 years old	37	36.6
	40-49 years old	27	26.7
	≥50 years old	32	31.7
Sex	Male	88	87.1
	Female	13	12.9
Working period	1-5 years	23	22.8
	6-10 years	30	29.7
	11-15 years	24	23.8
	≥16 years	24	23.8

Most of the companies have been in operation 26 years above (40.6%), between 5-15 years (39.6 %), (19.8 %) for between 16-25 years. Thirty five point six (35.61 %) of the companies are in textile industry, 16.8% are in wood and wood products, 12.9 % in food, beverage and tobacco industry, 7.9% of industries are in metal products, machinery and equipment, and 26.7% of them are from other sectors. Majority of the firms (37.6 %) had 250 to 499 permanent employees, 24.8% companies had 500 to 999 employees, 21.8% of them had 1000 to 1499 employees, and 13.5.8% had ≥1500 permanent employees.

Table 2
Summary of Companies' Profile

Companies' profile	Categories	Number of respondent	Percentage (%)
Companies age	5-15 years	40	39.6
	16-25 years	20	19.8
	≥26 years	41	40.6
Industry classification	Manufacture of food, beverages, and tobacco	13	12.9
	Manufacture of textiles, clothing, and leather	36	35.6
	Manufacture of wood and wood products, including furniture	17	16.8
	Manufacture of fabricated metal products, machinery and equipment	8	7.9
	Others	27	26.7
Permanent employees	250-499	38	37.6
	500-999	25	24.8
	1000-1499	22	21.8
	≥1500	16	15.8

Factor Analysis

In order to determine the factors of the decline the 22 items put to the factor analysis test. The result of factor analysis presented in the table 3 below.

The factor analysis on causes of decline extracted four factors with item loading ranging from .53 to .89. Sixty seven point seven nine of the variance is

explained with eigenvalues of greater than 1. Factor 1 is identified as poor management with factor loadings ranging from .53 to .85 (Cronbach alpha = .93). Factor 2 represents the competitive changes with item loadings ranging from .73 to .89 (Cronbach alpha = .91). Factor three with item loadings ranging from .74 to .78 (Cronbach alpha = .77) represents of economic change. The last factor addressed the failure of major projects with item loadings ranging from .65 to .88 (Cronbach alpha = .86).

Table 3
Factor Analysis on Causes of Decline

Items	Component			
	Factor 1 Poor management	Factor 2 Competitiv e changes	Factor 3 Economic changes	Factor 4 Failure of major projects
X3.4	.855			
X3.6	.854			
X3.5	.840			
X4.1	.816			
X4.3	.809			
X4.2	.789			
X3.3	.763			
X3.7	.699			
X3.2	.536			
Reliability	.93			
X2.5		.893		
X2.4		.888		
X2.3		.818		
X2.6		.816		
X2.2		.814		
X2.1		.734		
Reliability		.91		
X1.4			.786	
X1.1			.769	
X1.2			.761	
X1.3			.740	
Reliability			.77	
X5.2				.882
X5.3				.857
X5.1				.650
Reliability				.86
Eigenvalues	7.48	23.72	2.37	1.54
Percentage variance explained	34.04	16.92	10.80	6.03

Table 4 below shows two factors emerged as turnaround strategies, accounting for 65.74 percent of the variance explained, with item loadings ranging

from .66 to .89. Factor 1 identified three items, which appeared to be relating to management strategies. Factor loadings ranged from .85 to .89 (Cronbach alpha = .85). Factor 2 addressed the restructuring strategies. Factor loadings ranged from .66 to .80 (Cronbach alpha = .74). The items included in this factor such as new manufacturing methods and establishing new distribution methods.

Table 4
Factor Analysis on Turnaround Strategies

Items	Component	
	Factor 1 Management strategies	Factor 2 Restructuring strategies
X8.3	.894	
X8.2	.868	
X8.1	.851	
Reliability	.85	
X11.1		.805
X10.2		.773
X11.2		.771
X11.3		.668
Reliability		.74
Eigenvalues	2.72	1.87
Percentage variance explained	38.96	26.78

Restatement of hypothesis

Based on the result of factor analysis, the new model and hypothesis proposed are:

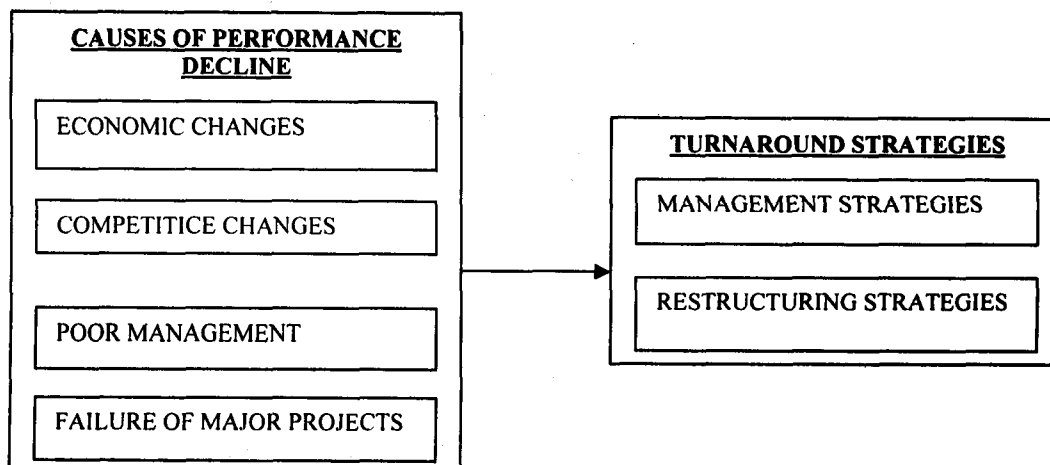


Figure 2
Corporate Turnaround Model

Figure 2 shows the new framework from the result of factor analysis. The restatements of hypothesis are:

- Hypothesis 1: Economic changes will lead to management strategies.
- Hypothesis 2: Economic changes will lead to restructuring strategies.
- Hypothesis 3: Competitive changes will lead to management strategies.
- Hypothesis 4: Competitive changes will lead to restructuring strategies.
- Hypothesis 5: Poor management will lead to management strategies.
- Hypothesis 6: Poor management will lead to restructuring strategies.
- Hypothesis 7: Failure of major projects will lead to management strategies.
- Hypothesis 8: Failure of major projects will lead to restructuring strategies.

Correlation

The results of correlation analysis provided in Table 5 below. The table shows that economic changes only have positive relationships with restructuring strategies ($r = .64$ p value $<.01$), but do not have any relationship with management strategies. Competitive changes do not have any positive and significant relationship with management strategies and restructuring strategies. Poor management factor have positive relationships with management strategies ($r = .37$ p value $<.01$) and restructuring strategies ($r = .20$ p value $<.05$). Lastly, failure of major projects also have positive and significant relationships with both strategies, management strategies ($r = .25$ p value $<.05$), and cutback strategy ($r = .21$ p value $<.05$).

The mean values show that competitive changes is rated the most serious factor contributing to the decline during the crisis in 1997/1998 in Indonesian manufacturing firms followed by poor management, economic changes, and failure of major projects. It also shows that restructuring strategies are the most important strategies used by the companies as compared to management strategies.

Table 5
Correlation Table

Variables	Mean	1	2	3	4	5	6
Causes of Decline							
1. Economic changes	3.80						
2. Competitive changes	4.17	.12					
3. Poor management	4.09	.16	.24(*)				
4. Failure of major projects	3.71	.08	.12	.56(**)			
Turnaround strategies							
5. Management strategies	2.71	.17	.05	.37(**)	.25(*)		
6. Restructuring strategies	4.13	.64(**)	.05	.20(*)	.21(*)	.18	

Regression Analysis

Table 6:
The Relationship Between Causes of
Performance Decline with Turnaround Strategies

Causes of decline	Turnaround strategies			
	Management strategies		Restructuring strategies	
	Std. Beta	t-value	Std. beta	t-value
Economic changes	.12	1.27	.63**	8.14
Competitive changes	-.05	-.56	-.05	-.63
Poor management	.33**	2.87	.02	.26
Failure of major projects	.06	.55	.15*	1.66
	$R^2 = .16$		$R^2 = .44$	
	adjusted $R^2 = .12$		adjusted $R^2 = .41$,	
	sig. F = .002		sig. F = .000	

* significant at .1 **significant at .05

The regressions above show there is no significant relationship between economic changes and management strategies. Hypothesis 1 rejected. However, economic changes have positive and significant relationship with restructuring strategies, thus, hypothesis 2 supported. Competitive changes do not have any significant relationship with management and restructuring strategies, this is to say that hypothesis 3 and 4 rejected. While, poor management has significant relationship with management strategies ($\beta = .33$), it means that the seriousness of poor management will lead to the use of management strategies, and hypothesis 5 supported. Nevertheless, poor management does not have any significant relationship with restructuring strategies, thus, hypothesis 6 rejected. Regarding hypothesis 7, that failure of major projects will lead to management strategies is not significant (hypothesis 7 rejected), but hypothesis 8 is accepted, as failure of major project will lead to restructuring strategies is proved significant.

Conclusion

From the results, it can be conclude that in Indonesia, competitive changes and poor management is the most serious factor contributing into the decline during the crisis. This poor management problem occurred because of these large conglomerates organized businesses. These conglomerates are associated with unfair business practices (Simanjuntak, 2001), which occurred on a big scale in the relationship between a group owned bank with the group's other members. Firstly, banks give loans to group members with little or no collateral leading to companies having extremely high gearing. When the banks recall the loans at the onset of the crisis, the companies cannot repay. Secondly, the practice of transfer pricing and profit or cost centers have been deployed in the relationship between two or more businesses of the same group. Transfer pricing in its explicit and implicit forms are perhaps the most pertinent issues of conglomeration (Simanjuntak, 2001). Some firms treated as cost centers, while others as profit centers. The cost centers were to show losses for accounting purposes, while the

profits shown elsewhere. Usually firms in the downstream industry might treat as profit centers and upstream operations as cost centers.

Secondly, economic change was serious a factor that contributed to the decline during the economic crisis in 1997/1998. During the crisis in 1997/1998, the depreciation of Rupiah was a major problem for firms that borrowed funds dominated in US dollar. Firms have to pay seven times more. At the same time, inflation rate rose from about eight percent to more than 11%.

Lastly, the failure of major projects was also a serious factor that contributed to the decline. In Indonesian manufacturing firms, many companies had problems on timely implementation of the projects coupled with underestimating of capital requirements. Since economic crisis in 1997/1998 many companies could not finish their projects on time because of the difficulties in get capital and raw materials that require other currencies (mainly US Dollars), because of the instability of the Rupiah (US \$1 = Rp.15,000). The other factor that contributed to the failure was the underestimating of capital requirements. It means that before crisis, the company had budgeted by a certain sum for the project, but when the economic crisis hit the companies, the budget was no longer sufficient for the project.

The results indicate the choice turnaround strategies depended on the causes of the decline. Specifically, firms are likely to choose management strategies if they perceived high levels of poor management. Firms are also likely to choose restructuring strategies if they perceived high levels of economic change and failure of major projects. However, the firms do not choose management strategies if they perceived competitive changes while in the West this problem is associated with management strategies. This finding supports what (Bruton, Ahlstrom, & Wan 2003) found that turnaround strategies that are important in the West not automatically used in the East.

As expected, poor management has positive association with management strategies, this result contradicts with the result of Bruton, Ahlstrom, & Wan (2003) study. He found in East Asia the removal of the firm's leaders is rarely done, particularly by outsiders such as the board or even by creditors. In Indonesia, when poor management seen as a factor contributing to the decline, new leader would replace the current leader during the crisis in 1997/1998. Nevertheless, the new leader was also from the owner family members or the person who has close relationship with the company.

The result of this study showed that competitive changes do not have any relationship with management strategies and restructuring strategies. In a situation that firms are faced with price competition, the emergence of foreign low cost producers, product competition, the appearance of entirely new company, the announcement of competitor's new range of products, and the merger of two competitors as factors contributing to performance decline, the management strategies, and restructuring strategies will not be the alternative. This could be one of the reasons why until 2001, the turnaround in Indonesia was slow in its progress and has little impact to the performance.

There are several limitations to this study. Firstly, the sample chosen is only the large companies. This study may not be generalized to small and medium enterprises. Secondly, this paper does not consider the success of implementing turnaround strategy as represented by firm performance. That will form the subject of another paper. Finally, the study focused only on economic crisis situation in 1997/1998, the result may be different if this model is applied to normal economic conditions. In conclusion, this study suggests there is merit to study the causes of decline and their concomitant turnaround strategies.

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